Solutions

FOR THE TAX ADVISOR 4th Quarter 2008

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IRS PROVIDES RELIEF FOR SMALL DEFINED BENEFIT PENSION PLANS

The new defined benefit pension plan funding rules enacted as part of the Pension Protection Act of 2006 (PPA) require a plan's actuary to certify the plan's "adjusted funded target attainment percentage" (AFTAP) for 2008 calendar year plans no later than September 30, 2008 in order to avoid significant limitations on future benefit accruals and lump sum distributions.

This certification is based on a plan's valuation date, which, with the exception of plans with 100 or fewer participants, must be the first day of the plan year (i.e., January 1, 2008 for calendar plan years). Many small plans with 100 or fewer participants have elected end-of-year valuation dates. The Internal Revenue Service has indicated that it cannot issue any guidance on how a plan with an end-of-year valuation date can make such a certification by September 30, 2008 until technical corrections are made to PPA.

In the absence of such authority, the IRS has issued two pieces of transitional relief for the 2008 certification for small defined benefit pension plans with end-of-year valuation dates: (1) IRS Notice 2008-73, which would essentially allow such plans to adopt a beginning-of-year valuation date for the 2008 year; and (2) a September 18, 2008 Special Edition of *Employee Plans News*, which would allow such plans to use the end-of-year valuation results for the 2007 year (with appropriate adjustments) in order to make an "initial" certification as of the first day of the 2008 plan year, provided that the actuary makes a subsequent certification based on the plan's end-of-year valuation date and that such subsequent determination does not result in a material change.

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IRS UPDATES EMPLOYEE PLANS COMPLIANCE RESOLUTION SYSTEM (EPCRS)

The Internal Revenue Service has issued a revenue procedure, Rev. Proc. 2008-50, to update the Employee Plans Compliance Resolution System (EPCRS). This is the comprehensive system of correction programs for sponsors of certain tax-favored retirement plans that have not, for a period of time, met all of the applicable requirements. Under EPCRS, plan sponsors can correct certain of these failures and thereby continue to provide their employees with retirement benefits on a tax-favored basis. Rev. Proc. 2008-50 modifies and supersedes the prior revenue procedure that governed EPCRS – Rev. Proc. 2006-27 (2006-1 CB 945 (as modified by Rev. Proc. 2007-49, 2007-30 IRB 141). The new procedures are generally effective January 1, 2009, but plan sponsors can choose to apply them on or after September 2, 2008.

DECEMBER 31, 2008 DEADLINE FOR 409A COMPLIANCE

Section 409A of the Internal Revenue Code regulating nonqualified deferred compensation plans (NQDC), was enacted as part of the American Jobs Creation Act of 2004. Proposed regulations in 2005, final regulations in 2007 and several good faith compliance transitional extensions have finally led to a full compliance deadline of December 31, 2008. 409A was enacted by Congress to curtail abuses in the NQDC plans of World Com and Enron. Fortunately, these highly popular executive compensation strategies, which are particularly effective for recruiting and retaining executives in closely held and family businesses, have escaped essentially unharmed by these new regulations. That being said, however, professional advisors need to make sure that these plans comply with the new requirements in order to avoid disqualification and penalty taxes.

Section 409A generally applies to any nonqualified arrangement or plan that provides for the payment of compensation or benefits in a year later than the year the services were performed.

Identify All Plans Subject to 409A

Section 409A generally applies to any nonqualified arrangement or plan that provides for the payment of compensation or benefits in a year later than the year the services were performed. Covered plans include pure salary deferral plans, Supplemental Executive Retirement Plans (SERPs), Death Benefit Only Plans, 457(f) plans, discounted stock options, and Stock Appreciation Rights. Excluded are qualified plans such as pension, profit sharing and 401(k)s, 403(b) plans, 45b plans, Simplified Employee Pension Plans (SEPs), Savings Incentive Match Plans for Employees (SIMPLEs), bona fide vacation, sick pay, and disability plans.

Written Requirement

All plans that are subject to 409A must be in writing and in full compliance with the final regulations by December 31, 2008. Existing plans may need amended and plans that have not been in writing must be drafted. Participant employees must be informed of and agree to any needed amendments. Properly executed and signed documents must be completed by the end of the year.

(i) The amount which the service provider has a right to be paid (or, in the case of an amount determinable under an objective, nondiscretionary formula, the terms of such formula);

(ii) The schedule or triggering events that will result in a payment of the amount;

(iii) The six-month delay requirement for payments to specified employees of publicly-traded companies upon separation from service (no later than the time such provision may be applicable); and

(iv) The conditions under which a deferral election may be made.

These items represent the minimum provisions that must be in the plan document in order to satisfy the written plan requirement. Other optional provisions permitted under the final regulations may need to be in the plan document if a plan elects to include such provisions.

The documentation requirements must be satisfied no later than December 31, 2008. However, the preamble to the final regulations states that any amendments are required only to bring the document into compliance effective January 1, 2009, and are not required to reflect any amendments made or actions taken under the transition rules to the extent such amendments or actions do not affect the plan's compliance with 409A for periods on or after January 2, 2009. Plan sponsors must also be able to demonstrate that the plan was operated in compliance with the transition guidance, including that amounts were deferred or paid in compliance with the transition rules.

IRA CHARITABLE ROLLOVER EXTENDED

On October 3, 2008, Congress passed and the President signed the Emergency Economic Stabilization Act of 2008 (H.R. 1424), legislation that includes extension of the IRA charitable rollover. The provision originally enacted as part of the Pension Protection Act of 2006 (PPA), permits IRA owners starting at age 70 ½ to make tax-free charitable gifts totaling up to $100,000 per year from their IRAs directly to eligible charities, including schools, colleges and universities and has been extended to December 31, 2009.

This "qualified charitable distribution" is excluded from the donor's adjusted gross income.

How Does It Work?

- Precludes the funding of gift annuities and similar life income plans.
- Applies only to donors age 70 ½ or older.
- The donor requests his or her IRA plan administrator to transfer funds to a charitable organization (donor-advised funds, supporting organizations, and private foundations are not included under the provisions).
- The IRA administrator transfers funds directly to the charity.
- This "qualified charitable distribution" is excluded from the donor's adjusted gross income.

Benefits of the IRA Rollover

- Qualified charitable distributions are excluded from the donor's adjusted gross income. Note: IRAs may be funded with pre- or post-tax dollars, and assets distributed from the IRAs may, accordingly, be taxable or nontaxable. Only IRA distributions that would be included as taxable income if withdrawn by the account holder count as "qualified charitable distributions" and can be excluded from income. If donors choose to distribute nontaxable IRA funds to a charity, they may still be able to claim a charitable tax deduction for the amount of the gift. Prospective donors should consult with tax advisors before making any charitable distributions from IRAs.

- IRA account holders over age 70 ½ are subject to required distribution rules. Qualified charitable distributions from IRA accounts count toward the owner's required minimum distributions.

- "Qualified charitable distributions" (i.e., charitable rollovers of funds which can be excluded from a donor's income) are not included as part of the donor's maximum allowable charitable tax deductions. This means that IRA rollover gifts do not count toward 50 percent of their adjusted gross income limitation on charitable gifts of cash.

- Required IRA distributions may increase an individual's adjusted gross income and increase the percentage of Social Security payments on which he or she has to pay tax. By choosing to make a charitable distribution with all or part of their required IRA distribution, donors may reduce income and reduce the percentage of Social Security subject to taxation.

- The IRA rollover allows donors who do not itemize deductions to contribute IRA assets to charities and enjoy tax benefits similar to those derived from claiming itemized charitable deductions.

- Taxpayers in states that do not allow itemized deductions and follow federal income inclusion rules may realize state tax benefits by making charitable qualified distributions from their IRAs.

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Fourth Quarter 2008 • Solutions is published quarterly.

Securities and advisory services offered through affiliate Ameritas Investment Corp., Member FINRA/SIPC.

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